



Financial Management Report

AS OF MARCH 31, 2008

AT A GLANCE:

General Fund revenues ahead of last year by 2.9 percent. Sales tax revenue performance continues negative trend for first quarter 2008 (see page 5)

Development revenue down overall (see page 3)

Fuel prices up = fuel tax revenue down? (see page 1)

Eastside home sales fall 22 percent; prices are flat (see page 8)

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Summary of All Operating Funds: *Revenue*

- General Fund** actual 2008 revenue is **2.9 percent ahead** of the same period last year largely due to higher utility tax and plan check revenue. This is despite disappointing sales tax revenue and a significant decline in building permit revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- Other General Government Funds** actual 2008 revenue is **2.9 percent ahead** of the same period last year due to higher internal service rates, higher recreation fee revenue (earlier registrations for summer classes and a new fitness pass program), and a significant insurance recovery for park property damage. This is despite a 30 percent decline in motor vehicle fuel tax revenue and variability in timing of cable tax revenue. Motor vehicle fuel tax is collected on a flat rate per gallon and distributed by the State based on population. Increased fuel costs that decrease consumption (fewer gallons sold) have a negative impact on this revenue.
- Water Sewer Operating Fund** actual 2008 revenue is **6.3 percent higher** than last year due primarily to sewer rate revenue and an increase in connection charge fee revenue. Budgeted revenue increased 8 percent over 2007 due to higher rates. Actual revenue is tracking slightly lower, at 6.3 percent. This is within a normal seasonal variation for this fund.
- Surface Water Management Fund** Surface Water fees are paid through property tax collection, which are primarily received in April and October. Revenue can be somewhat volatile depending on the timing of property tax collections. Actual 2008 revenue is **24.1 percent ahead** of the same period last year illustrating this volatility since the utility rate did not increase from 2007 to 2008.
- Solid Waste Fund** revenue collection was budgeted to increase in 2008 over 2007 due to higher rates and normal growth. Actual 2008 revenue is **1.7 percent ahead** of the same period last year, which is slightly lower than planned due to normal variability in billing collections.

Resources by Fund	Year-to-Date Actual			Budget			% of Budget	
	3/31/2007	3/31/2008	% Change	2007	2008	% Change	2007	2008
General Gov't Operating:								
General Fund	10,292,628	10,589,068	2.9%	54,543,885	53,236,722	-2.4%	18.9%	19.9%
Other General Gov't Operating Funds	3,090,597	3,180,216	2.9%	17,133,704	17,060,113	-0.4%	18.0%	18.6%
Total General Gov't Operating	13,383,225	13,769,284	2.9%	71,677,589	70,296,835	-1.9%	18.7%	19.6%
Utilities:								
Water/Sewer Operating Fund	3,669,418	3,901,126	6.3%	16,494,804	17,821,208	8.0%	22.2%	21.9%
Surface Water Management Fund	234,850	291,465	24.1%	5,233,189	5,274,145	0.8%	4.5%	5.5%
Solid Waste Fund	1,925,842	1,957,833	1.7%	7,909,347	8,365,262	5.8%	24.3%	23.4%
Total Utilities	5,830,110	6,150,424	5.5%	29,637,340	31,460,615	6.2%	19.7%	19.5%
Total All Operating Funds	19,213,335	19,919,708	3.7%	101,314,929	101,757,450	0.4%	19.0%	19.6%

* Budgeted and actual revenues exclude resources forward and include interfund transfers.



**Reality TV Wins Kirkland
Youth Council
International Recognition**

An educational video produced by the City of Kirkland, with the acting support of the Kirkland Youth Council, has been selected as an International Safety Media Awards (ISMA) Silver winner. "We've Got Issues/Pedestrian Safety" – a public service announcement video on youth pedestrian safety – was judged by an international panel comprised of safety experts from around the world. The video includes actual film footage of inattentive high school drivers and pedestrians. The City was honored at the 9th World Injury Prevention and Safety Promotion conference in Merida, Mexico, March 16-18, 2008. The Alaska Injury Prevention Center, a non-profit organization in Anchorage, Alaska, is sponsoring the 2nd International Safety Media Awards. The video can be viewed on the City's web-site:

www.ci.kirkland.wa.us

Summary of All Operating Funds: *Expenditures*

- **General Fund** expenditures were budgeted to increase in 2008 over 2007 largely due to increased personnel costs. Actual expenditures are **10.8 percent ahead** of the same period last year primarily due to higher employee salary and benefit costs (including the settlement of labor contracts with back payments for 2007).
- **Other Operating Funds** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of vehicle purchases. Actual expenditures are **2.5 percent ahead** of the same period last year primarily due to higher personnel costs.
- **Water/Sewer Operating Fund** Actual 2008 expenditures are only **0.4 percent ahead** of the same period last year primarily due to a significant reduction in regional connection charges and despite higher personnel, water purchase, and METRO sewer costs.
- **Surface Water Management Fund** expenditures were budgeted to decrease in 2008 over 2007 primarily due to the timing of one-time projects and despite higher personnel costs. Actual 2008 expenditures are **20.6 percent ahead** of the same period last year due to significant progress made on plans previously budgeted.
- **Solid Waste Fund** expenditures were budgeted to increase in 2008 over 2007 due to higher solid waste contract rates. Actual 2008 expenditures are **7.5 percent ahead** of the same period last year due to normal variability in disposal contract billing payment amounts.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	3/31/2007	3/31/2008	% Change	2007	2008	% Change	2007	2008
General Gov't Operating:								
General Fund	12,750,860	14,122,915	10.8%	54,787,102	56,232,016	2.6%	23.3%	25.1%
Other General Gov't Operating Funds	3,753,681	3,847,048	2.5%	17,364,419	17,013,678	-2.0%	21.6%	22.6%
Total General Gov't Operating	16,504,541	17,969,963	8.9%	72,151,521	73,245,694	1.5%	22.9%	24.5%
Utilities:								
Water/Sewer Operating Fund	4,302,860	4,319,013	0.4%	16,919,851	16,918,779	0.0%	25.4%	25.5%
Surface Water Management Fund	520,403	627,511	20.6%	5,646,029	5,525,222	-2.1%	9.2%	11.4%
Solid Waste Fund	1,933,793	2,078,784	7.5%	7,860,184	8,221,762	4.6%	24.6%	25.3%
Total Utilities	6,757,056	7,025,308	4.0%	30,426,064	30,665,763	0.8%	22.2%	22.9%
Total All Operating Funds	23,261,597	24,995,271	7.5%	102,577,585	103,911,457	1.3%	22.7%	24.1%

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and include interfund transfers.

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development-related fees.

General Fund Revenue

- **Sales tax** revenue for 2008 was expected to increase slightly over 2007. Instead, actual 2008 revenue is **down 0.5%** compared to the same period last year. A detailed analysis of **sales tax** revenue can be found starting on page 5.
- **Utility tax** actual revenue collection is **6.7 percent ahead** of the same period last year primarily due to growth in electricity and telephone tax revenue.
- **Other taxes** actual revenue is **70.3 percent ahead** of the same period last year due to the one-time receipt of E-911 tax revenue for reimbursement of dispatch equipment and over-time.
- **Business licenses and franchise fees** actual revenue is **6.8 percent ahead** of the same period last year due to strong franchise fee revenue. The **revenue generating regulatory license** fee is **4.8 percent ahead** of the same period last year, in part due to collection of delinquent accounts. Variability of the timing of renewals from larger businesses can skew year-to-year comparisons.
- **Development-related fees** revenues are a mixed bag. Actual 2008 revenue is **down 3.9 percent collectively** over the same period last year. **Building/structural permits** actual 2008 revenue is **24.9 percent lower** than the same period in 2007. **Plan check** fees actual revenue is **46.2 percent higher** compared to the same period in 2007. **Other development fees** and **engineering services fees** are **down 18.8 percent** and **24.6 percent respectively** compared to the same period last year. The trends for development-related revenue in 2008 reflect the volatility that is inherent in development activity and also are reflected in sales tax revenue performance (see page 5).
- **Grant** revenue is **down 65.1 percent** compared to the same period last year due to the normal variability in the number of grants received.
- **Fines and forfeits** revenue is **16.5 percent ahead** of the same period last year due to normal variability of this revenue.

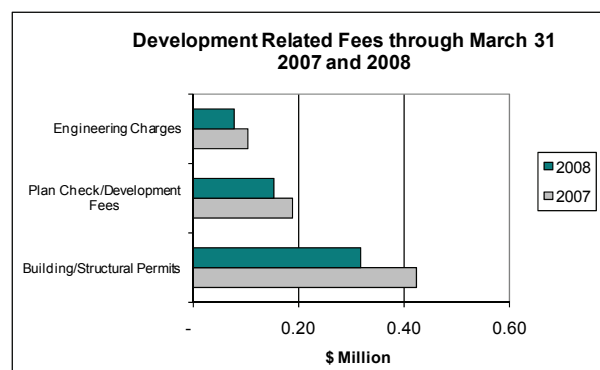
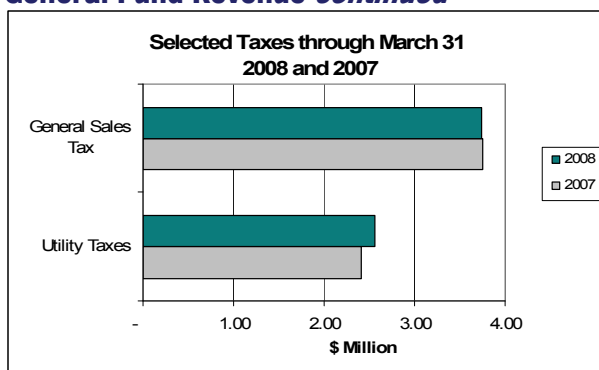
General Fund 2008 revenues are only \$0.3 million ahead of the same period in 2007 largely due to utility taxes, plan check fees, and other taxes. This is despite weak sales tax revenue and declines in building permits, other development fees, and grants.

The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

About 374 of the City's 470 permanent employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	3/31/2007	3/31/2008	% Change	2007	2008	% Change	2007	2008
Taxes:								
Retail Sales Tax: General	3,755,081	3,734,554	-0.5%	15,918,981	16,104,800	1.2%	23.6%	23.2%
Retail Sales Tax: Criminal Justice	280,977	302,397	7.6%	1,114,253	1,050,000	-5.8%	25.2%	28.8%
Property Tax	385,463	408,933	6.1%	8,790,086	9,030,480	2.7%	4.4%	4.5%
Utility Taxes	2,404,986	2,565,108	6.7%	8,723,683	8,145,822	-6.6%	27.6%	31.5%
Rev Generating Regulatory License	265,644	278,475	4.8%	936,671	990,000	5.7%	28.4%	28.1%
Other Taxes	105,221	179,184	70.3%	462,597	453,500	-2.0%	22.7%	39.5%
Total Taxes	7,197,372	7,468,651	3.8%	35,946,271	35,774,602	-0.5%	20.0%	20.9%
Licenses & Permits:								
Building, Structural & Equipment Permits	422,598	317,195	-24.9%	2,078,436	2,163,450	4.1%	20.3%	14.7%
Business Licenses/ Franchise Fees	363,170	387,873	6.8%	1,421,435	1,449,450	2.0%	25.5%	26.8%
Other Licenses & Permits	32,458	72,070	122.0%	188,749	193,900	2.7%	17.2%	37.2%
Total Licenses & Permits	818,226	777,138	-5.0%	3,688,620	3,806,800	3.2%	22.2%	20.4%
Intergovernmental:								
Grants	88,265	30,815	-65.1%	182,160	18,500	-89.8%	48.5%	166.6%
State Shared Revenues & Entitlements	138,870	151,055	8.8%	623,230	645,318	3.5%	22.3%	23.4%
Fire District #41	-	-	N/A	3,184,310	3,358,499	N/A	N/A	N/A
EMS	-	-	N/A	504,376	519,507	N/A	N/A	N/A
Other Intergovernmental Services	166,341	139,922	-15.9%	589,478	439,609	-25.4%	28.2%	31.8%
Total Intergovernmental	393,476	321,792	-18.2%	5,083,554	4,981,433	-2.0%	7.7%	6.5%
Charges for Services:								
Internal Charges	840,636	870,068	3.5%	3,443,777	3,511,012	2.0%	24.4%	24.8%
Engineering Services	104,269	78,570	-24.6%	635,000	610,000	-3.9%	16.4%	12.9%
Plan Check Fee	276,220	403,960	46.2%	958,700	900,000	-6.1%	28.8%	44.9%
Other Development Fees	189,197	153,635	-18.8%	968,960	1,194,637	23.3%	19.5%	12.9%
Recreation	-	5,790	N/A	79,516	83,000	4.4%	N/A	7.0%
Other Charges for Services	187,672	158,515	-15.5%	880,191	653,174	-25.8%	21.3%	24.3%
Total Charges for Services	1,597,994	1,670,538	4.5%	6,966,144	6,951,823	-0.2%	22.9%	24.0%
Fines & Forfeits	208,873	243,283	16.5%	1,317,860	1,132,000	-14.1%	15.8%	21.5%
Miscellaneous	76,687	78,828	2.8%	553,002	404,150	-26.9%	13.9%	19.5%
Total Revenues	10,292,628	10,560,230	2.6%	53,555,451	53,050,808	-0.9%	19.2%	19.9%
Other Financing Sources:								
Interfund Transfers	-	28,838	N/A	988,434	185,914	N/A	N/A	15.5%
Total Other Financing Sources	-	28,838	N/A	988,434	185,914	N/A	N/A	15.5%
Total Resources	10,292,628	10,589,068	2.9%	54,543,885	53,236,722	-2.4%	18.9%	19.9%

* Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued***General Fund Expenditures**

General Fund Department Expenditures	Year-to-Date Actual			Budget			% of Budget	
	3/31/2007	3/31/2008	% Change	2007	2008	% Change	2007	2008
Non-Departmental	243,917	259,270	6.3%	1,128,527	1,202,474	6.6%	21.6%	21.6%
City Council	128,848	138,745	7.7%	316,392	359,934	13.8%	40.7%	38.5%
City Manager's Office	689,715	957,767	38.9%	3,468,879	3,605,217	3.9%	19.9%	26.6%
Human Resources	242,015	249,226	3.0%	1,036,649	1,126,554	8.7%	23.3%	22.1%
City Attorney's Office	218,180	231,167	6.0%	997,460	1,013,008	1.6%	21.9%	22.8%
Parks & Community Services	1,153,409	1,331,957	15.5%	5,888,034	5,996,291	1.8%	19.6%	22.2%
Public Works (Engineering)	918,037	867,620	-5.5%	3,786,746	3,574,763	-5.6%	24.2%	24.3%
Finance and Administration	827,999	872,827	5.4%	3,417,487	3,573,612	4.6%	24.2%	24.4%
Planning & Community Development	852,065	934,741	9.7%	4,107,113	3,475,234	-15.4%	20.7%	26.9%
Police	3,245,152	3,914,132	20.6%	14,114,877	14,783,667	4.7%	23.0%	26.5%
Fire & Building	4,106,446	4,224,432	2.9%	15,819,578	16,383,585	3.6%	26.0%	25.8%
Total Expenditures	12,625,783	13,981,884	10.7%	54,081,742	55,094,339	1.9%	23.3%	25.4%
Other Financing Uses:								
Interfund Transfers	125,077	141,031	12.8%	705,360	1,137,677	61.3%	17.7%	12.4%
Total Other Financing Uses	125,077	141,031	12.8%	705,360	1,137,677	61.3%	17.7%	12.4%
Total Expenditures & Other Uses	12,750,860	14,122,915	23.5%	54,787,102	56,232,016	63.2%	23.3%	25.1%

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

2008 expenditure budgets were higher than 2007 for most departments primarily due to higher personnel costs, including an unsettled labor contract from 2007 that settled in 2008. In addition to this general trend, specific highlights and budget to actual comparisons by selected departments are listed below:

- Actual 2008 expenditures for the **City Manager's Office** are **38.9 percent ahead** of the same period last year primarily due to the payment of NORCOM regional dispatch transition costs and also higher personnel salaries and benefit costs.
- Actual 2008 expenditures for the **Parks & Community Services Department** are **15.5 percent ahead** of the same period last year primarily due to the timing of human service agency contract payments.
- Actual 2008 expenditures for the **Public Works Department** are **5.5 percent behind** the same period last year primarily due to a position vacancy and the completion of the one-time Verizon fiber project inspection.
- Actual 2008 expenditures for the **Planning Department** are **9.7 percent ahead** of the same time last year primarily due to the timing of payments to ARCH (A Regional Coalition for Housing), an environmental impact review for a downtown shopping center, and despite position vacancies.
- Actual 2008 expenditures for the **Police Department** are **20.6 percent ahead** of the same period last year

(Continued on page 5)

Compared to 2007, 2008 General Fund actual expenditures are tracking slightly ahead of last year primarily due to higher personnel costs, settlement of a labor contract that included back-pay for 2007 in 2008, and timing of major projects.

due primarily to higher personnel costs, back payment of 2007 wages as a result of a labor contract settlement, staffing vacancies in 2007, and higher jail costs.

- Actual 2008 expenditures for the **Fire & Building Department** are **2.9 percent ahead** of the same period last year largely due to the timing of Fire dispatch contract costs. While down slightly from the same period last year, fire operations overtime costs remain a concern.



A "green" cottage development in Kirkland

We have winners:

- Kirkland recently received national recognition for its Innovative Active Aging program. This award program recognizes outstanding community planning and strategies that support active aging and smart growth thereby improving the quality of life for older residents. The award was accepted by Deputy Mayor Joan McBride at an award ceremony held by the Environmental Protection Agency in Washington, D.C. in February.
- The City's Green Building Program received the "Build Green Hammer Award" in the "Build Green Advocate, Public Sector" category. Built Green is a program of the Master Builders Association in partnership with King and Snohomish Counties. Kirkland recently issued its first "green" building permit, which entitled the recipient to an expedited review process.
- Everyone likes to complain about red tape. It was refreshing to hear that Kirkland tied for first place with the City of Renton in a recent survey by the Master Builders for the jurisdiction with the best permit process. This accolade demonstrates Kirkland's commitment to customer service and the City's knowledgeable development services staff.

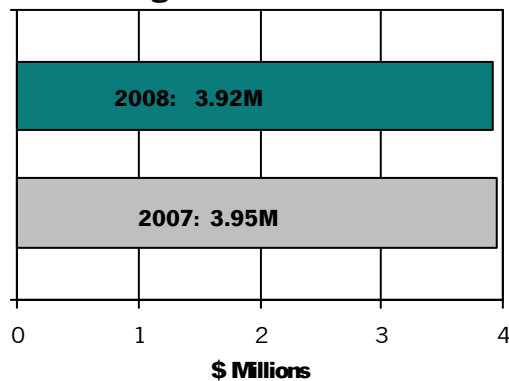
Sales Tax Revenue Analysis

2008 actual revenue is **down 0.5 percent** compared to the same period last year primarily due to significant softening in contracting revenue (see table on page 6).

Review by business sectors:

- The **contracting** sector is **down 14.7 percent** compared to the same period last year due to the completion of major projects and a general weakening in development activity. A small upswing in March is the result of two new large projects in progress.
- The **wholesale** sector is **up 19 percent** over the same period last year due to the level of development activity in this sector compared to last year in contrast to the negative performance in other development-impacted sectors.
- The **services** sector is **up 10 percent** compared to the same period last year largely due to the accommodations industry as a result of one new hotel and the renovation of another.
- Retail eating/drinking** is **up 12.2 percent** compared to the same period last year due to relatively good results from several larger businesses as well as the collection of a past-due account from prior years.
- Auto/gas retail**, usually one of the strongest "ongoing" performers, is faltering this year **up only 1.7 percent** over the same period last year primarily due to significant negative performance in March.
- General merchandise/miscellaneous retail** is **down 3.4 percent** compared to the same period last year due to disappointing performance by key retailers—possibly a sign of weakening consumer confidence.
- Other retail declined 3.7 percent** compared to the same period last year due to the closure of two major retailers.

**Sales Tax Receipts
through March 2008 and 2007**



Auto/ gas retail growth helped balance declines in development revenue in 2007, but slowed during first quarter 2008.

This report summarizes results through March 31, 2008. April and May results have shown significant declines, with receipts thru May down 9.5%.

Bellevue 2008 sales tax revenue is up 8 percent over the same period last year primarily due to the high level of development-related activity in 2007. Redmond sales tax revenue is flat, up only 0.6 percent.

City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January - March		Dollar Change	Percent Change	Percent of Total	
	2007	2008			2007	2008
Services	406,094	446,858	40,764	10.0%	10.3%	11.4%
Contracting	750,763	640,744	(110,019)	-14.7%	19.0%	16.3%
Communications	136,160	141,346	5,186	3.8%	3.4%	3.6%
Auto/Gas Retail	775,882	788,835	12,953	1.7%	19.7%	20.1%
Gen Merch/Misc Retail	664,759	642,270	(22,489)	-3.4%	16.8%	16.4%
Retail Eating/Drinking	284,880	319,565	34,685	12.2%	7.2%	8.1%
Other Retail	455,563	438,544	(17,019)	-3.7%	11.5%	11.2%
Wholesale	248,893	296,070	47,177	19.0%	6.3%	7.5%
Miscellaneous	224,582	212,820	(11,762)	-5.2%	5.8%	5.4%
Total	3,947,576	3,927,052	(20,524)	-0.5%	100.0%	100.0%

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2007 and 2008 year-to-date sales tax receipts in the table to the left.

Month	Sales Tax Receipts		Dollar Change	Percent Change
	2007	2008		
January	1,267,021	1,227,855	(39,166)	-3.1%
February	1,525,665	1,586,493	60,828	4.0%
March	1,154,890	1,112,704	(42,186)	-3.7%
Total	3,947,576	3,927,052	-20,524	-0.5%

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in March is for sales actually made in January. Monthly sales tax receipts through March 2007 and 2008 are compared in the table to the left.

February 2008 experienced the only positive monthly increase compared to the same month in the prior year since July 2007.

2008 sales tax revenue is budgeted to increase 1.2 percent compared to actual performance of a decline of 0.5 percent compared to the same period last year.

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and businesses with no physical presence in Kirkland.

Totem Lake, which accounts for over 32 percent of the total sales tax receipts, is **up only 1.4 percent** compared to the same period last year primarily due to the closure of two major retailers and despite strong performance in auto/gas retail. Over 60 percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for over 14 percent of the total sales tax receipts, is **down 4.1 percent** compared to the same period last year primarily due to the automotive/gas retail and general merchandise/miscellaneous retail. Almost 80 percent of this business district's revenue comes from these two business sectors.

Downtown, which accounts for over 7 percent of the total sales tax receipts, is **up 5.8 percent** compared to the same period last year primarily due to moderately strong performance in the retail eating/

drinking and accommodations sectors, which provide over 40 percent of this business district's revenue and despite declines in other retail and miscellaneous sectors (manufacturing).

Carillon Point & Yarrow Bay, which accounts for almost 4 percent of the total sales tax receipts, is **up 23.6 percent** compared to same period last year primarily due to strong performance in the business services and hotel sectors. Almost 70 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for almost 4 percent of the total sales tax receipts, is **down 1.1 percent** compared to the same period last year almost entirely due to miscellaneous retail, which provides almost 32 percent of these business districts' revenue.

Juanita, which accounts for just over 2 percent of the total sales tax receipts, is **up 18.4 percent** compared to the same period last year primarily due to the retail eating/drinking sector, which provides over 40 percent of this business district's revenue.

When reviewing sales tax receipts by business district, it's important to point out that 39 percent of the revenue received in 2008 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

Business District	Jan - Mar Receipts		Dollar Change	Percent Change	Percent of Total	
	2007	2008			2007	2008
Totem Lake	1,250,788	1,268,897	18,109	1.4%	31.7%	32.3%
NE 85th St	592,503	568,161	-24,342	-4.1%	15.0%	14.5%
Downtown	267,173	282,612	15,439	5.8%	6.8%	7.2%
Carillon Pt & Yarrow Bay	104,512	129,215	24,703	23.6%	2.6%	3.3%
Houghton & Bridle Trails	147,113	145,481	-1,632	-1.1%	3.7%	3.7%
Juanita	70,273	83,193	12,920	18.4%	1.8%	2.1%
Unassigned or No District:						
Contracting	750,763	640,745	-110,018	-14.7%	19.0%	16.3%
Other	764,451	808,748	44,297	5.8%	21.2%	22.7%
Total	3,947,576	3,927,052	-20,524	-0.5%	100.0%	100.0%

Sales Tax Revenue Outlook The disappointing performance in the retail sectors, especially automotive/gas retail, may be a sign of lagging consumer confidence. While down from last year, development-related revenue still remains relatively strong in relation to historical trends but could drop even more dramatically if the economy continues to slow. A major impact is expected from Costco opening stores in Redmond and Bellevue some time in 2009-2010. By their estimates, the Kirkland store will lose about one third of their sales from the opening of the new stores and this impact would be felt possibly starting in late 2009. In addition, a major automobile dealership is planning to relocate their sales activities outside the City limits.

Developing ongoing business activity is critical to ensure the City's financial health. Opportunities for growth in ongoing revenue exist from the redevelopment of Totem Lake Mall and Park Place, the completed expansions of major car dealerships, and the two additional hotels. These risks and opportunities serve as reminders that sales tax is an economically sensitive revenue source. In good times, sales tax growth easily outpaces the rate of inflation and is an attractive funding source for service packages. On the other hand, an economic recession and the return of more normal development-related activity can quickly threaten the City's financial ability to maintain existing services (as it did in 2002).

OFFICE VACANCIES:
The Eastside vacancy rate remains low at 9.3 percent and Kirkland's rate is 4.7 percent as of the first quarter of 2008 according to CB Richard Ellis Real Estate Services.

LODGING TAX REVENUE:
Lodging tax 2008 revenue is up 12.6 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel, which opened downtown in late 2007.

Economic Environment Update Once again, mixed economic indicators: Local job growth continues to be strong in 2008 with almost 127,000 jobs added in the Seattle-Tacoma metropolitan area since January 2005. The unemployment rate in King County is 3.6 percent as of March 2008, well below the national and Washington State average of 5.2 percent. While less glowing than 2007, the Puget Sound region economic climate is forecasted to be relatively bright in 2008 compared to the national forecast according to Conway Pedersen Economics. The reasoning is the local economy is more in tune with the international economy with exports of Boeing airplanes and Microsoft software.

However, the Puget Sound office market saw its first quarter of negative absorption in 5 years. The Eastside office market continued strong performance, with positive absorption. Even with the one quarter of negative regional absorption, the Puget Sound region office market is expected to remain one of the strongest in the nation for some time.

Two of the local confidence indexes illustrate concerns by local executives and purchasing managers. The Hebert Research-Business Journal Confidence Index survey posted another sharp drop for the first quarter of 2008, hitting its lowest level since the last recession ended in 2003. At 50.5, the index is almost 4 points lower than the prior quarter and well under the historical mean of 55.9. The Western Washington purchasing managers survey showed flagging optimism in the state's economy, falling 7.7 points to 53.5 in March and the 90-day forecast dropped 3.6 points to 56.6. (It should be noted that a score of more than 50 points signals an expanding economy, while a score of less than 50 points indicates a shrinking economy.)

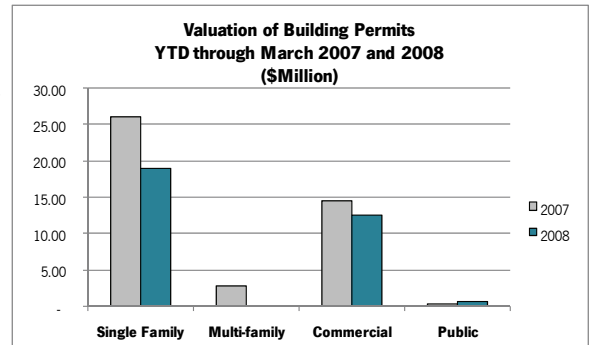
As mentioned in the sales tax analysis, significant risks from business changes and slowing development activity could pose a financial challenge in the near future for the City.

(Continued on page 8)

Local **development activity** comparing 2008 to 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart below. Activity has dropped considerably—in the single family and multi-family sectors especially. Concerns about the slowing local real estate market could have a significant impact on residential development activity in 2008.

Pending sales of **new and existing single-family homes** in King County are down 39 percent in March 2008 compared with a year earlier and prices declined 3.3 percent for closed sales compared to the same month last year.

The median price of a single family home in March was \$439,900—down from \$455,000 in March 2007. On the Eastside, closed sales of single family homes are down 22 percent and the median price is down 6.7 percent to \$592,725. Contributing factors to the slow-down in sales are housing prices overshooting wages, economic uncertainty and tightening consumer credit. Local economists predict 2008 housing prices to flatten to zero or decline as part of market correction and the demand for housing will keep the correction time short. A more positive housing outlook was depicted from the PMI Mortgage Insurance Company's Spring 2008 U.S. Market Risk Index, which ranks the nations' 50 largest metropolitan areas according to the likelihood that home prices will be lower in two years. The Puget Sound region is rated relatively low risk with a score of 5 percent compared to Riverside-San Bernardino-Ontario CA with a score of 93 percent and Las Vegas with a score of 91 percent.

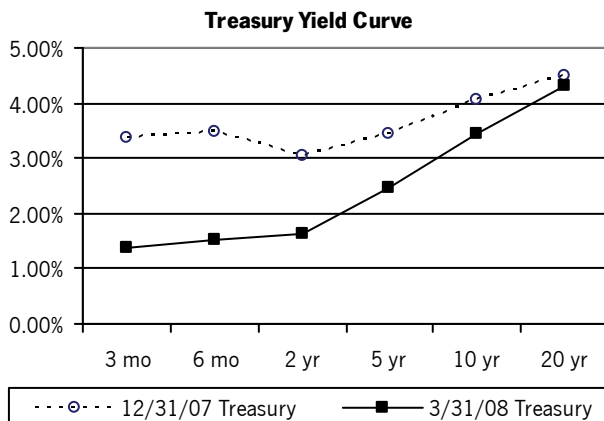


Seattle metro CPI continues to track higher than the national average (5.1 percent compared to the national average of 4.4 percent as of February). This is an increase from the Seattle index for June 2007, which was 3.31 percent. The June 2007 CPI is used to calculate City employee cost of living adjustments (COLA) for 2008. As a result, 2008 COLA's range from 2.98 to 3.31 percent depending on the bargaining unit contract.

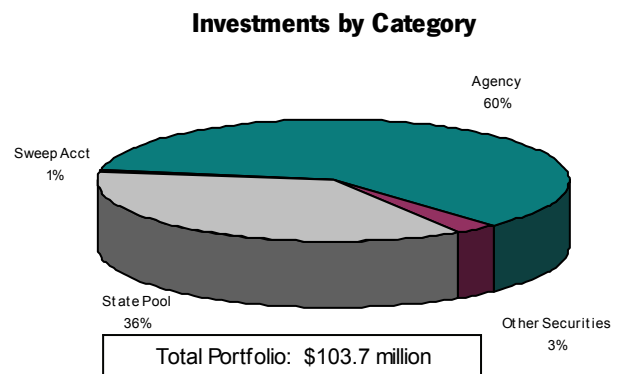
Investment Report

MARKET OVERVIEW

Fed Funds rate dropped dramatically from 4.25 percent to 2.25 percent during the first quarter of 2008 as the fallout of the subprime mortgage market continued to impact the economy. The yield curve decline was greater in the 3 month to five year range creating a more normal upward sloping yield curve.



The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio decreased slightly in the 1st quarter of 2008 to \$103.7 million compared to \$105.9 million on December 31, 2007.



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, US Treasury notes, the State Investment Pool and an overnight bank sweep account. City investment procedures allow for 100% of the portfolio to be invested in US Treasury or Federal Government obligations.

2008 ECONOMIC OUT-LOOK and INVESTMENT STRATEGY

The outlook for 2008 continues to look poor with the weak economic growth and the severity of the housing downturn. However, the economists are not predicting a contraction. GDP growth for 2008 is expected to be 1.8% and core inflation to range between 2% and 2.2%. The forecasters see little threat of accelerating inflation. The unemployment rate is expected to average 5.1% in 2008. The Fed Funds rate, currently at 2.25% as of March 18, 2008, is expected to be further reduced at the April 30 meeting to 2.00%.

The duration of the portfolio will decrease as securities mature and are called. New security purchases will be made as opportunities for increased returns become available. During periods of low interest rates the portfolio duration should be kept shorter with greater liquidity so that the City is in a position to be able to purchase securities with higher returns when interest rates begin to rise. The State Pool is currently near 2.65% and will continue to decline as the Fed Funds rate declines. Total estimated investment income for 2008 is \$4.2 million.

Investment Report *continued*

Liquidity

The target duration for the City's portfolio is based on the 2 year treasury rate which decreased from 3.05 percent on December 31, 2007 to 1.62 percent on March 31, 2008. The average maturity of the City's investment portfolio increased slightly from 2.01 years on December 31, 2007 to 2.05 years on March 31, 2008 due to the purchase of longer term securities to lock in higher yields. It is expected that those securities will be called on their call dates as interest rates are declining.

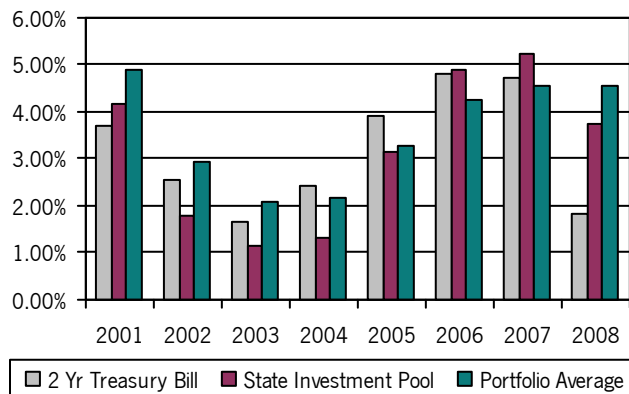
Yield

The City Portfolio yield to maturity decreased from 4.89 percent on December 31, 2007 to 4.27 percent on March 31, 2008. Through March 31, 2008, the City's annual average yield to maturity was 4.54 percent. The City's portfolio outperformed the State Investment Pool annual average yield to maturity of 3.76 percent and the 2 Year Treasury Note annual average for 2008 of 1.81 percent due to the rapid decline in interest rates.

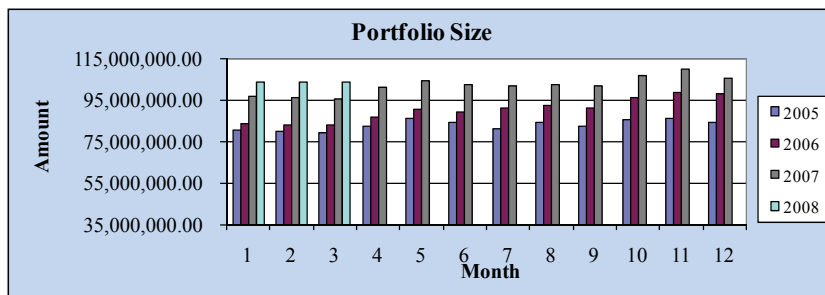
The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.

Benchmark Comparison	December 31, 2007	March 31, 2008
City Yield to Maturity (YTM)	4.89%	4.27%
City Average YTM	4.75%	4.54%
City Year to Date Yield	4.73%	4.48%
State Pool Average Yield	5.09%	3.76%
2 yr Treasury Note Avg YTM	4.27%	1.81%

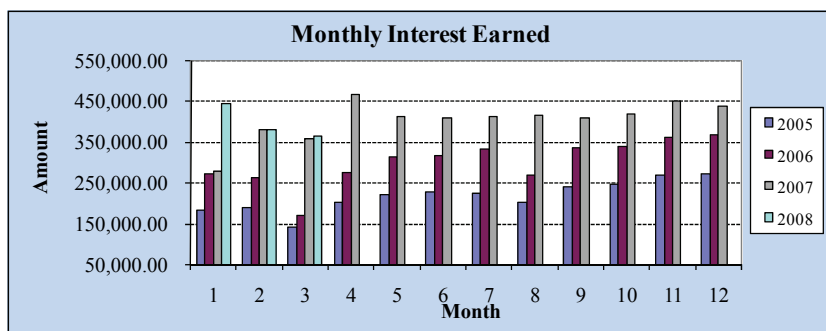
Investment Interest Rate Comparisons



Portfolio Size



Monthly Interest Earned



Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at \$.375 per \$1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2008 Auth. Uses	2008 Auth. Additions	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826			2,827,890
General Capital Contingency	3,312,834			3,312,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,921,002			1,911,002
Council Special Projects Reserve	309,960	5,000		271,960
Total General Purpose Reserves	13,532,838	5,000	0	13,118,902
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678			5,877,284
REET 2	6,067,898			6,067,898
Equipment Rental:				
Vehicle Reserve	5,907,138			5,907,138
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	453,670			453,670
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498			960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245	39,106		1,472,139
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640			1,203,440
Water/Sewer Construction Reserve	8,738,358			7,903,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	158,500		516,260
Surface Water-Transp. Related Rsv	1,417,365			1,181,365
Surface Water Construction Reserve	1,240,563			1,240,563
Total Special Purpose Reserves	48,011,479	197,606	0	45,083,179
Grand Total	61,544,317	202,606	0	58,202,081

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION
2008 Council Authorized Uses		
Council Special Projects Reserve	\$5,000	Funding for 2008 membership dues to the Cascade Land Conservancy to become a Cascade Agenda Leadership City.
Water/Sewer Operating Reserve	\$39,106	Funding for the emergency repair of a watermain leak on NE 85 th Street.
Surface Water Capital Contingency	\$158,500	Additional funding for the Juanita Creek Channel Enhancement project.
2008 Council Authorized Additions		
No Council Authorized Additions as of March 31, 2008.		

The summary in the section above details all Council authorized uses and additions to each reserve through March 2008.

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,827,890	3,698,455	(870,565)
General Capital Contingency	3,312,834	5,822,280	(2,509,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	271,960	250,000	21,960
General Purpose Reserves with Targets	11,207,900	15,048,936	(3,841,036)
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	5,877,284	1,435,000	4,442,284
REET 2	6,067,898	4,959,200	1,108,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,472,139	1,511,245	(39,106)
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	1,203,440	1,703,640	(500,200)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	516,260	876,760	(360,500)
Special Purpose Reserves with Targets	20,240,424	15,950,130	4,290,294
Reserves without Targets	26,753,757	n/a	n/a
Total Reserves	58,202,081	n/a	n/a

The table to the left compares the revised ending balance to the targets established in the budget process .



123 5th Avenue
Kirkland, Washington 98033
425-587-3101

- ◆ Tracey Dunlap, Director of Finance & Administration
- ◆ Michael Olson, Deputy Director of Finance & Administration
- ◆ Sandi Hines, Financial Planning Manager
- ◆ Sri Krishnan, Senior Financial Analyst
- ◆ Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

The **Financial Management Report (FMR)** is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a summary **budget to actual** comparison for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis Report** takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

Economic Environment Update References:

- *Purchasing managers less optimistic about economy*, Puget Sound Business Journal, April 9, 2008
- *Survey finds gloomy Puget Sound area execs planning to rein in spending*, Puget Sound Business Journal, May 2, 2008
- Elizabeth Rhodes, *Home prices declining, inventory building around Puget Sound*, The Seattle Times, April 4, 2008
- CB Richard Ellis Real Estate Services, Market View Puget Sound, First Quarter 2008
- Northwest Multiple Listing Service
- Washington State Economic and Revenue Forecast Council
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- U.S. Bureau of Labor Statistics
- City of Kirkland Building Division
- City of Kirkland Finance Department